Oil-What Can We Afford?

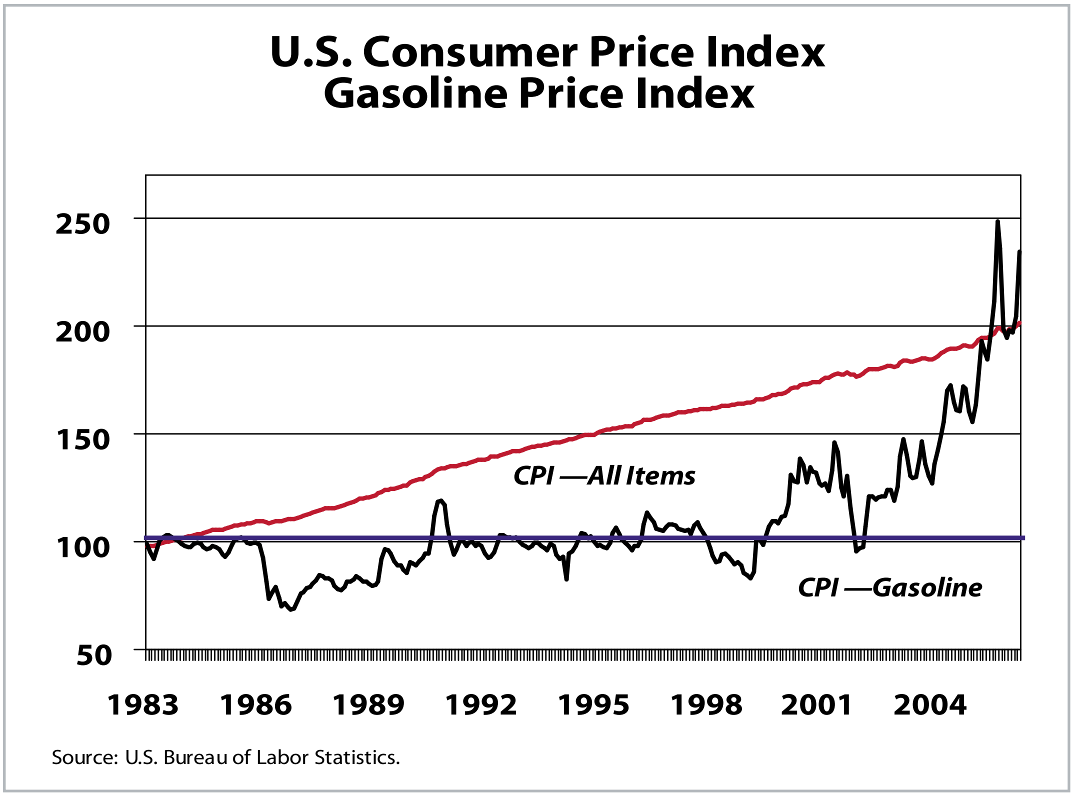
The price of oil is again on the rise. Prognosticators tell us to expect at least $3 a gallon at the pumps this summer. The reality will probably be something higher. With that climb, gasoline returns as one of the most high-profile of consumer purchases.

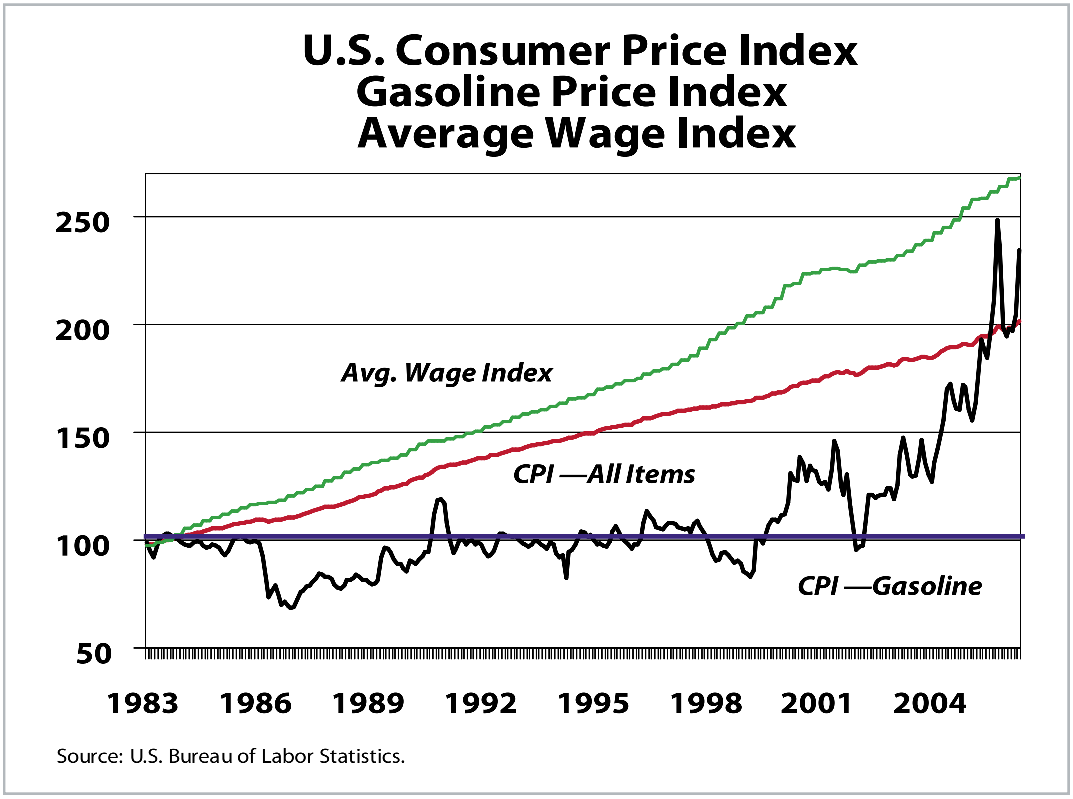
Yet for all the chatter and complaining we did last summer as gasoline prices climbed near $3 a gallon, why didn't all that squawking translate into a cutback in gasoline purchases, and in turn, a slowing in the United States economy? The answer may be that a gasoline price at or above $3 a gallon, in terms of our ability to afford it and in relation to the price rise of other goods over time, is not drastically above where it should be.

Should be? In relation to what? In relation to the United States Consumer Price Index (CPI) and its rise over the past 20 years. Since gasoline prices vary across regions — based upon differing factors like tax prices, additives, and others — let's revert our focus back to a more singular variable, the price of a barrel of oil.

The Consumer Price Index has risen steadily since 1983 (the current index base year). The CPI has slightly more than doubled since January, 1983. Back then, the price of a barrel of West Texas Intermediate Crude was selling for $31 a barrel. If we let the price of oil rise equal to the CPI, then current oil would be selling in the $63- to $65-a-barrel range.

At the time of this writing, oil is selling around $73 a barrel. By the time you read this, it could possibly be higher. But that increase is largely attributed to a summer spike, and the oil price is anticipated to retreat again by year end. To what level do prognosticators expect the oil price to settle back? Around $65 a barrel—just where the CPI would place it.





The CPI measures only the cost of goods and services. What about our ability to afford those goods and services? To determine that you look at wages and wage growth. The CPI has risen 104 percent since 1983. Average U.S. wages across that same period have risen by 170 percent. Did you recognize an earnings power increase? What if oil prices rose equal to the average wage increase? How much would oil be then? Answer: $84 per barrel.